

## Submission by the European Union on the Inflation Reduction Act

**November 2022**

*The Delegation of the European Union to the United States of America presents its compliments to the Internal Revenue Service and has the honour to submit comments by the European Union on aspects of the Inflation Reduction Act, further to the requests for comments made by the Internal Revenue Service on 6 October 2022.*

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The European Union acknowledges the importance of the Inflation Reduction Act (“the Act”) and the United States’ ambition to address global climate change and promote green transition policy goals.

However, despite its laudable intentions, the European Union cannot but voice serious concerns regarding the way that the financial incentives under the Act are designed, both as regards specific provisions, notably their discriminatory nature, but also their cumulative, potentially adverse effects on the EU’s industry.

The European Union takes note of the United States Government’s ongoing work to implement the Act and notably a request for comments<sup>1</sup> issued on 6 October 2022 by the Internal Revenue Service on the different aspects of extensions and enhancements of energy tax benefits in the Inflation Reduction Act to feed into the ongoing work of drafting guidance for the implementation of the Act.

The European Union would like to offer the United States its preliminary views on the Act and reserves the right to complement these observations at a later stage. These go beyond the questions set out in the notices issued by the IRS. The European Union would also like to underline that these written observations present a contribution to a wider process of engagement with the United States through which it hopes to find constructive and amicable solutions to the concerns expressed. In this respect, the European Union welcomes the joint announcement on 25 October 2022 of the launch of the US-EU Task Force on the Inflation Reduction Act. The Task Force is a clear, senior level commitment by the United States to address the serious concerns raised by the European Union in relation to the Act.

The European Union has concerns at this stage in particular over nine of the Act’s tax credit provisions which are further detailed in the Annex:

- Extension and Modification of credit for Electricity from Certain Renewable Resources Tax Credit
- Extension and Modification of Energy Tax Credit
- Sustainable Aviation Fuel Tax Credit
- Tax Credit for Production of Clean Hydrogen
- Clean Vehicle Tax Credit
- Advanced Manufacturing Production Tax Credit
- Clean Electricity Production Tax Credit
- Clean Electricity Investment Tax Credit

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<sup>1</sup> Notice 2022-46PDF requests comments on credits for clean vehicles; Notice 2022-47PDF requests comments on energy security tax credits for manufacturing. Notice 2022-48PDF requests comments on incentive; provisions for improving the energy efficiency of residential and commercial buildings.; Notice 2022-49PDF requests comments on certain energy generation incentives.; Notice 2022-50PDF requests comments on elective payment of applicable credits and transfer of certain credits. ; Notice 2022-51PDF requests comments on prevailing wage, apprenticeship, domestic content, and energy communities requirements.;

- Clean Fuel Production Tax Credit

While each of these tax provisions is problematic by itself, the potential for cumulative market distortion and possible adverse effect is even greater. Given their size and design, the financial incentives deployed to meet the United States' climate objectives unfairly tilt the playing field to the advantage of production and investment in the United States at the expense of the European Union and other trading partners of the United States, potentially resulting in a significant diversion of future investment and production, threatening jobs and economic growth in Europe and elsewhere.

Having access to subsidised low-carbon technologies and sources of clean energy, key parts of the United States economy will receive a market-distorting boost, tilting the global level playing field and turning a common global objective – fighting climate change – into a zero-sum game. This will lead to an increased distortion of global markets for industries delivering green hydrogen, solar, wind, batteries and electric vehicle solutions, and less efficient outcomes for the reduction of global greenhouse gas emissions that in the medium term will also be harmful for the US.

Furthermore, transatlantic trade, investment and integrated production and supply chains will suffer from disruptions and distortions. The effect of the Act on supply chain resilience and integration (transatlantic and beyond) is particularly worrying. Its intention of nationally reshoring supply and production chains to the United States and decoupling/diverting them from partners like the European Union could lead to negative effects both for the United States and other trading partners. It will contribute to limit sourcing of critical inputs and fuel a harmful competition for inputs at a time when both the US and the EU have committed to closer cooperation on supply chain resilience, as clearly stated in Joint Statement on Cooperation on Global Supply Chains of the Supply Chain Ministerial Forum on 20 July 2022 and the dedicated working tracks in the Trade and Technology Council.

Amongst these tax credits, the European Union has identified several that it deems to be particularly problematic given also that they contain provisions with clearly discriminatory domestic content requirements, in breach of WTO rules:

- Extension and Modification of credit for Electricity from Certain Renewable Resources
- Extension and Modification of the Energy Tax Credit
- Clean Vehicle Tax Credit
- Clean Electricity Production Credit
- Clean Electricity Investment Credit

Domestic content requirements violate the national treatment obligations reflected in the General Agreement on Tariffs and Trade (GATT 1994) and can also violate (i) the prohibition on import substitution subsidies in the Agreement on Subsidies and Countervailing Measures (ASCM) (to the extent that the tax credits are made contingent on the use of domestic over imported goods) and (ii) the prohibition on trade-related investment measures (TRIMs) inconsistent with national treatment obligations in the TRIMs Agreement.

Moreover, the Clean Vehicle Tax Credit not only introduces discriminatory content and production requirements but also has a North America final assembly provision which discriminates against final products imported into the US.

More generally, given that all the nine tax credit provisions seek to incentivise production in the US, their compatibility with the ASCM and GATT 1994 will depend notably on the adverse effects of the subsidies on the EU, US and third country markets, which the EU will monitor closely.

The European Union sees no justification for this discrimination against its economic operators or products. For the European Union, the green transition is not something to be achieved at the expense of others. On the contrary, international cooperation is a core part of our efforts to effectively promote the green agenda and economic resilience. While fully committed to a sustainable green transition (as set out in the very ambitious target of becoming fully carbon neutral by 2050), the European Union's approach to mitigating unmanageable levels of climate change showcases how transparent and non-discriminatory subsidies are the most efficient way to reduce greenhouse gas emissions. Companies and goods from the United States and elsewhere are allowed to compete on a level-playing field in the European Union's internal market. This has allowed US companies to become important providers of low-carbon solutions in Europe.

The approach set out in the problematic provisions of the Act may encourage other economies to follow the United States' example in deploying protectionist and discriminatory measures. This threatens the multilateral trading system at a time when its value is more important than ever for both American and European businesses.

If implemented in its current form, the Act risks causing not only economic damage to both the US and its closest trading partners, resulting in inefficiencies and market distortions, but could also trigger a harmful global subsidy race to the bottom on key technologies and inputs for the green transition. Moreover it risks creating tensions that could lead to reciprocal or retaliatory measures.

The European Union **calls on the United States to remedy the problematic elements** of the Act, starting in particular by:

- Removing all discriminatory content and production requirements affecting the European Union and its economic operators and products
- Ensuring the EU and its economic operators are treated no less favourably than other trading partners of the United States
- Building transparency provisions into subsidies to be granted through tax credits and other programmes under the Act to advance the green transition
- Ensuring that the level and structure of subsidization does not create adverse effects on the EU

The **annex to this note provides detailed input** on the problematic elements the EU has identified at this stage and to the extent possible preliminary observations on those concrete provisions the EU would particularly request to be reviewed.

The European Union would like to underline that the United States Government is best suited to identify the ways and means to address these concerns.

The European Union looks forward to our joint engagement in the EU-US Task Force on the Inflation Reduction Act to set out concrete, amicable solutions to the EU's concerns. The European Union welcomes the US engagement and looks forward to working on solutions. We remain strong, constructive partners, and agree on the importance of close coordination to support sustainable and resilient supply chains across the Atlantic, including to build the clean energy economy.

### Annex – Overview of the EU’s concerns and requests for implementation

Name	Legal basis <sup>2</sup>	Product(s)/sector(s) covered	EU’s concerns and requests for implementation
<b>Extension and Modification of credit for Electricity from Certain Renewable Resources Tax Credit</b>	26 USC §45	Power generating facilities using wind, solar, geothermal, biomass, municipal waste or hydropower	<p>Paragraph (b)(9) and paragraph (b)(10) contain discriminatory provisions (against interests of EU suppliers in upstream industries) as the value of the incentive is conditional on domestic content requirements. The EU requests a general waiver or exception for EU produced goods to be treated equal to US produced goods by giving rise to the same amount of financial incentive.</p> <p>The financial value offered by 26 USC §45 is such that there are negative effects for the EU in terms of investment decisions in the renewables industry and a risk of adverse effects to the EU’s interests. In addition, EU-based upstream industries will be shut out of supply chains due to the domestic content requirements. The subsidy thus has a strong market distorting character within and outside the US. The subsidy is unbound in financial value as there is no spending or production cap, which the EU requests to change in accordance to achieve shared climate policy goals while protecting a level-playing field. To ensure the needed subsidy transparency, the EU requests the introduction of public reporting and notification requirements for taxpayers availing themselves of this tax credit.</p>
<b>Extension and Modification of Energy Tax Credit</b>	26 USC §48	Power or heat generating facilities using wind, solar, geothermal, fuel cell, combined heat and power, waste, energy storage, or hydropower	<p>Paragraphs (a)(12) and (a)(13) refers to 26 USC §45 paragraphs (b)(9) and (b)(10) respectively, thus introducing discriminatory provisions (against interests of EU suppliers in upstream industries) as the value of the incentive is conditional on domestic content requirements. The EU requests a general waiver or exception for EU produced goods to be treated equal to US produced goods by giving rise to the same amount of financial incentive.</p> <p>The financial value offered by 26 USC §48 is such that there are negative effects for the EU in terms of investment decisions in the clean energy industry and a risk of adverse effects to the EU’s interests. In addition, EU-based upstream industries will be shut out of supply chains due to the domestic content requirements. The subsidy thus has a strong market distorting character within and outside the US. The subsidy is unbound in financial value as there is no spending or production cap, which the EU requests to change in accordance to achieve shared climate policy goals while protecting a level-playing field. To ensure the needed subsidy transparency, the EU requests the introduction of public reporting and notification requirements for taxpayers availing themselves of this tax credit.</p>
<b>Sustainable Aviation Fuel Tax Credit</b>	26 USC §40B	Refining of aviation fuel	<p>Paragraph (c)(1) contains problematic domestic production requirements that, in conjunction with the requirements sale and the transfer to the fuel tank of aircraft within the US of paragraphs (c)(3) and (c)(4), puts EU-based producers at a disadvantage as they must compete on a distorted market with subsidised US-based producers. In addition, the subsidy might skew the playing field for the EU airline industry. The EU requests a shift of the production to a non-discriminatory consumption subsidy.</p>

<sup>2</sup> The legal basis refers to the US Internal Revenue Code as amended by the Inflation Reduction Act and codified under Title 26 of the US Code (26 USC).

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			<p>The financial value offered by 26 USC §40B is such that there are negative effects for the EU in terms of investment decisions and serious economic disadvantages for the EU airline industry. The subsidy thus has a strong market distorting character within and outside the US. The subsidy is unbound in financial value as there is no spending or production cap, which the EU requests to change in accordance to achieve shared climate policy goals while protecting a level-playing field. To ensure the needed subsidy transparency, the EU requests the introduction of public reporting and notification requirements for taxpayers availing themselves of this tax credit.</p>
<p><b>Tax Credit for Production of Clean Hydrogen</b></p>	<p>26 USC §45V</p>	<p>Hydrogen production</p>	<p>Paragraph (c)(2)(B)(i)(I) contains a problematic domestic production requirement that puts EU-based producers at a disadvantage as they must compete on a distorted market with subsidised US-based producers. The EU requests a shift of the production to a non-discriminatory consumption subsidy.</p> <p>The financial value offered by 26 USC §40B is such that there are negative effects for the EU in terms of investment decisions in the hydrogen industry and a risk of adverse effects to the EU's interests. The subsidy thus has a strong market distorting character within and outside the US. The subsidy is unbound in financial value as there is no spending or production cap, which the EU requests to change in accordance to achieve shared climate policy goals while protecting a level-playing field. To ensure the needed subsidy transparency, the EU requests the introduction of public reporting and notification requirements for taxpayers availing themselves of this tax credit.</p>
<p><b>Clean Vehicle Tax Credit</b></p>	<p>26 USC §30D</p>	<p>Mining, recycling, battery and automotive production</p>	<p>Paragraph (d)(1)(G) contains discriminatory final assembly provisions against interests of EU clean vehicle producers. The EU requests a general waiver or exception for EU produced clean vehicles that would otherwise qualify in absence of any problematic provisions in 26 USC §30D. EU (final) assembled clean vehicles should give rise to the same amount of financial incentive as North American (final) assembled clean vehicles in absence of any problematic provisions in 26 USC §30D.</p> <p>Paragraph (e)(1)(A)(i) contains discriminatory extraction and processing provisions against interests of EU extractors and processors of applicable critical minerals. The EU requests a general waiver or exception for EU extracted and processed critical minerals, or a qualification as partner with which the US has a "free trade agreement in effect". The usage of EU extracted and processed applicable critical minerals should give rise to the same amount of financial incentive as US extracted and processed applicable critical minerals in absence of any problematic provisions in 26 USC §30D.</p> <p>Paragraph (e)(1)(A)(ii) contains discriminatory recycling provisions against interests of EU recyclers of applicable critical minerals. The EU requests a general waiver or exception for EU recycled critical minerals. The usage of EU recycled applicable critical minerals should give rise to the same amount of financial incentive as North American recycled applicable critical minerals in absence of any problematic provisions in 26 USC §30D.</p> <p>Paragraph (e)(2)(A) contains discriminatory battery component provisions against interests of EU producers of batteries and battery components. The EU requests a general waiver or exception for EU manufactured or assembled batteries and battery components. The usage of EU manufactured or assembled batteries and battery components should give rise to the same</p>

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			<p>amount of financial incentive as North American manufactured or assembled batteries and battery components in absence of any problematic provisions in 26 USC §30D.</p> <p>The financial value offered by 26 USC §30D is such that there are negative effects for the EU in terms of investment decisions in the automotive, battery and critical minerals industry and a risk of adverse effects to the EU's interests. In addition, EU-based upstream industries will be shut out of supply chains due to the domestic content requirements. The subsidy thus has a strong market distorting character within and outside the US. The subsidy is unbound in financial value as there is no spending cap, which the EU requests to change in accordance to achieve shared climate policy goals while protecting a level-playing field. To ensure the needed subsidy transparency, the EU requests the introduction of public reporting requirements for the US Government on the type and number of clean vehicles subsidised by 26 USC §30D.</p>
<b>Advanced Manufacturing Production Tax Credit</b>	26 USC §45X	Low-carbon energy technologies (e.g. solar, wind, batteries), low-carbon mobility solutions, critical mineral	<p>Paragraph (d)(2) contains a problematic domestic production requirement that puts EU-based producers at a disadvantage as they must compete on a distorted market with subsidised US-based producers. The EU requests a shift of the production to a non-discriminatory consumption subsidy. The exceptional acceptance of intra-firm sales under 26 USC §45X paragraph (a)(3)(A) and election for grant payment possibility under 26 USC §6417 paragraph (d)(1)(D) is aggravating the market distorting effect and will help US exports with an unfair competitive advantage, which the EU therefore requests to remove.</p> <p>The financial value offered to US producers by 26 USC §45X is such that there are negative effects for the EU in terms of investment decisions in the covered sectors and a risk of adverse effects to the EU's interests. The subsidy thus has a strong market distorting character within and outside the US. The subsidy is unbound in financial value as there is no spending or production cap, which the EU requests to change in accordance to achieve shared climate policy goals while protecting a level-playing field. To ensure the needed subsidy transparency, the EU requests the introduction of public reporting and notification requirements for taxpayers availing themselves of this tax credit.</p>
<b>Clean Electricity Production Tax Credit</b>	26 USC §45Y	Electricity generators using low-carbon power generation sources	<p>Paragraph (g)(11) and paragraph (g)(12)(C) contain discriminatory provisions (against interests of EU suppliers in upstream industries) as the value of the incentive is conditional on domestic content requirements. The EU requests a general waiver or exception for EU produced goods to be treated equal to US produced goods by giving rise to the same amount of financial incentive.</p> <p>The financial value offered by 26 USC §45Y is such that there are negative effects for the EU in terms of investment decisions in electricity production and a risk of adverse effects to the EU's interests. In addition, EU-based upstream industries will be shut out of supply chains due to the domestic content requirements. The subsidy thus has a strong market distorting character within and outside the US. The subsidy is unbound in financial value as there is no spending or production cap, which the EU requests to change in accordance to achieve shared climate policy goals while protecting a level-playing field. To ensure the needed subsidy transparency, the EU requests the introduction of public reporting and notification requirements for taxpayers availing themselves of this tax credit.</p>

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<b>Clean Electricity Investment Tax Credit</b>	26 USC §48E	Electricity generators building low-carbon power generation sources	<p>Paragraphs (a)(3)(B) and (d)(5) ultimately refer to 26 USC §45 paragraph (b)(9)(B) and 26 USC §45Y paragraph (g)(12)(C) respectively, thus introducing discriminatory provisions (against interests of EU suppliers in upstream industries) as the value of the incentive is conditional on domestic content requirements. The EU requests a general waiver or exception for EU produced goods to be treated equal to US produced goods by giving rise to the same amount of financial incentive.</p> <p>The financial value offered by 26 USC §48E is such that there are negative effects for the EU in terms of investment decisions and a risk of adverse effects to the EU's interests. In addition, EU-based upstream industries will be shut out of supply chains due to the domestic content requirements. The subsidy thus has a strong market distorting character within and outside the US. The subsidy is unbound in financial value as there is no spending or production cap, which the EU requests to change in accordance to achieve shared climate policy goals while protecting a level-playing field. To ensure the needed subsidy transparency, the EU requests the introduction of public reporting and notification requirements for taxpayers availing themselves of this tax credit.</p>
<b>Clean Fuel Production Tax Credit</b>	26 USC §45Z	Refining of aviation and non-aviation fuel	<p>Paragraph (f)(1) contains problematic domestic production requirements that puts EU-based producers at a disadvantage as they must compete on a distorted market with subsidised US-based producers. The EU requests a shift of the production to a non-discriminatory consumption subsidy.</p> <p>The financial value offered by 26 USC §45Z is such that there are negative effects for the EU in terms of investment decisions and a risk of adverse effects to the EU's interests. The subsidy thus has a strong market distorting character within and outside the US. The subsidy is unbound in financial value as there is no spending or production cap, which the EU requests to change in accordance to achieve shared climate policy goals while protecting a level-playing field. To ensure the needed subsidy transparency, the EU requests the introduction of public reporting and notification requirements for taxpayers availing themselves of this tax credit.</p>